

Message Text

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PAGE 01 BRASIL 03671 01 OF 02 091511Z

ACTION ARA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 INR-07 NSAE-00

PA-01 USIA-06 PRS-01 SP-02 IO-13 IGA-02 AID-05

EB-07 NSC-05 EPG-02 TRSE-00 SS-15 STR-04 OMB-01

CEA-01 COME-00 FRB-03 XMB-02 OPIC-03 LAB-04

SIL-01 /096 W

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R 091430Z MAY 77

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 1508

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

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EO 11652 NA

TAGS EFIN BR

SUBJECT: INFLATION: CRITICISMS AND SOLUTIONS

1. SUMMARY: GOB'S ANTI-INFLATIONARY PROGRAM COMES UNDER SHARP DOMESTIC CRITICISM AS INFLATION SHOWS NO SIGNS OF ABATING IN APRIL. THE CONOMIC DEVELOPMENT COUNCIL REAFFIRMS THE GOB'S GRADUALISTIC ACTION PLAN AND APPROVES ADDITIONAL ANTI-INFLATIONARY MEASURES. LACK OF PROGRESS ON INFLATION FRONT, PLUS APPARENT LACK OF OFFICIAL DETERMINATION, ADVERSELY AFFECTS CONFIDENCE. SIMONSEN MAINTAINS THAT THE GOVERNMENT'S PROGRAM HAS YET TO MAKE ITS FULL IMPACT FELT AND THE HE IS OPTIMISTIC THAT INFLATION WILL BEGIN IMPROVING AROUND MID-YEAR.END SUMMARY.

2. WITH INFLATION SHOWING NO SIGNS OF ABATING- THE RATE OF INFLATION IN APRIL IS EXPECTED TO EXCEED 4.0 PERCENT, BRINGING CUMULATIVE INFLATION FOR THE FIRST FOUR MONTHS CLOSE TO 16.0 PERCENT-THE GOB HAS COME UNDER SEVERE DOMESTIC CRITICISM FOR LACKING AN EFFECTIVE AND CREDIBLE ANTI-
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PAGE 02 BRASIL 03671 01 OF 02 091511Z

INFLATIONARY PROGRAM. IN UNUSUALLY HARSH LANGUAGE, FORMER FINANCE MINISTER BULHOES-THE INTELLECTUAL LEADER OF THE CURRENT GENERATION OF BRAZILIAN ECONOMISTS AND A PUBLIC FIGURE WITH IMPECCABLE PRESTIGE, IN A SPEECH BEFORE THE FEDERATION OF INDUSTRIES OF RIO DE JANEIRO--ACCUSED THE GOVERNMENT OF NOT TAKING THE FIGHT AGAINST INFLATION SERIOUSLY ENOUGH. HE ATTRIBUTED THE CURRENT PHASE OF INFLATION TO AN EXCESSIVELY EXPANSIONARY CREDIT POLICY,

MADE POSSIBLE BY STOP-GO MONTARY POLICIES. IN SUPPORT OF HIS ARGUMENT, BULHOES CITED DATA WHICH SHOW THAT THE LEVEL OF DEBT FINANCING BY BRAZILIAN INDUSTRY HAS REACHED A DANGEROUSLY HIGH LEVEL. IN 1964 ABOUT 75 PERCENT OF BUSINESS CAPITAL WAS DERIVED FROM INTERNALLY-GENERATED FUNDS AND FROM THE SALE OF STOCKS AND THE REMAINING 25 PER CENT FROM BANK CREDIT, WHEREAS IN 1974 THESE PROPORTIONS WERE REVERSED. AS ANOTHER INDICATION OF THIS CREDIT EXPLOSION, HE NOTED THAT IN 1972 TOTAL OUTSTANDING CREDIT WAS THE EQUIVALENT OF 41.9 PERCENT OF GDP, WHILE IN 1976 IT JUMPED TO 60 PERCENT. BULHOES SAID IT WAS "CRIMINAL" THAT THE GOVERNMENT WAS NOT UTILIZING A GREATER PORTION OF FORCED SAVINGS (PIS/PASEP) TO CAPITALIZE INDUSTRY.

3. THE FORMER MINISTER ALSO TOOK THE CENTRAL BANK TO TASK FOR ITS INCONSISTENT "OPEN MARKET" POLICIES. WHILE HE INDICATED THAT HE HAD NO HARD EVIDENCE TO SUBSTANTIATE THESE ARGUMENTS, HE HAD THE INTUITIVE FEELING THAT THE BANK WAS SELLING TREASURY BILLS, ON ONE HAND, TO ABSORB LIQUIDITY, WHILE, ON THE OTHER HAND, WAS PLACING THESE FUNDS WITH THE BANCO DO BRASIL, WHICH WAS RETURNING THEM TO THE ECONOMY THROUGH ITS UNLIMITED CREDIT POTENTIAL. HE ALSO STATED THAT DEALERS IN TREASURY BILLS OFTEN HAVE TO RESORT TO THE DISCOUNT WINDOW TO FINANCE THEIR STOCK AND PURCHASES OF LTNS. FINALLY, HE CLAIMED THAT WITH THE "PROLIFERATION" OF MONEY SUBSTITUTES (NEAR MONEY), PARTICULARLY SHORT-TERM SAVINGS DEPOSITS WITH MONETARY CORRECTIONS, IT WAS BECOMING INCREASINGLY DIFFICULT TO FORMULATE AND EXECUTE MONETARY POLICY.

4. THE ECONOMIC DEVELOPMENT COUNCIL (CDE), THE ECONOMIC POLICY-MAKING GROUP CHAIRED BY PRESIDENT GEISEL, MET ON MAY 4 TO DISCUSS LIMITED OFFICIAL USE

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PAGE 03 BRASIL 03671 01 OF 02 091511Z

THE INFLATION SITUATION.

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PAGE 01 BRASIL 03671 02 OF 02 091517Z

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LIMITED OFFICIAL USE SECTION 2 OF 2 BRASILIA 3671

IN A NOTE ISSUED AFTER THE MEETING, AND THROUGH COMMENTS MADE TO THE PRESS BY FINANCE MINISTER SIMONSEN, THE GOB REAFFIRMED ITS POLICY OF PURSUING A GRADUALISTIC APPROACH TO FIGHT INFLATION. SIMONSEN STATED THAT IMPLEMENTING A "SHOCK TREATMENT" WOULD REQUIRE RIGID PRICE AND WAGE CONTROLS AND "THIS IS NOT GOING TO HAPPEN." IN LINE WITH GOVERNMENT POLICY, THE CDE APPROVED THE FOLLOWING ADDITIONAL ANTI-INFLATIONARY MEASURES:

A) TO STANDARDIZE THE APPLICATION OF MONETARY CORRECTION BY HENCEFORTH USING ONLY ONE INDEX--THAT USED TO ADJUST GOVERNMENT BONDS (ORTNS). AT PRESENT, DIFFERENT PRICE INDEXES ARE USED TO ADJUST DIFFERENT ASSETS AND LIABILITIES FOR INFLATION;

B) TO LIMIT PRICE INCREASES ON "CRITICAL" PUBLIC SERVICES IN 1977 TO 25 PERCENT;

C) TO SET UP THE FISCALIZATION BY GOVERNMENT ENTITIES (COBAL AND SEPLAN) OF THE MARKETING CHANNELS FOR FRUITS AND VEGETABLES, THE PRICES OF WHICH HAVE BEEN PRIMARILY RESPONSIBLE FOR THE RECENT SPURT OF INFLATION;

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PAGE 02 BRASIL 03671 02 OF 02 091517Z

D) TO INSTITUTIONALIZE THE "CONFISCO CAMBIAL" (EXPORT TAX) ON EXPORT PRODUCTS, IN AN EFFORT TO SHIELD DOMESTIC PRICES (PARTICULARLY OF COFFEE AND SOYBEANS) FROM HIGH WORLD PRICES.

COMMENT:

5. BULHOES' ATTACK NO DOUBT JARRED THE GOVERNMENT SINCE HIS IS CONSIDERED AN INSIDER; HE IS ONE OF THE TWO PRIVATE SECTOR MEMBERS ON THE NATIONAL MONETARY COUNCIL. UNDER QUESTIONING BY THE PRESS, THE FINANCE MINISTER REFUSED TO BE DRAWN INTO A DIRECT PUBLIC DEBATE WITH BULHOES, LIMITED HIMSELF TO INDIRECT REPLIES TO THE LATTER'S CRITICISMS. WORKING LEVEL CONTACTS AT THE CENTRAL BANK AND FINANCE MINISTRY EXPRESSED AGREEMENT WITH THE GENERAL THRUST OF BULHOES' REMARKS BUT DISAGREED ON THE DETAILS- PARTICULARLY WITH REGARD TO HIS CRITICISM OF "OPEN MARKET"

POLICIES. (THEY MAINTAIN THAT IT IS NOT TRUE THAT THE MONEY IS BEING RELENT BY THE BANCO DO BRASIL.)

6. BULHOES REMARKS HAVE TO BE SEEN AS A PUBLIC EXPRESSION OF THE PERVASIVE DISSATISFACTION IN THE PRIVATE SECTOR WITH THE GOVERNMENT'S ANTI-INFLATIONARY PROGRAM, AND THE APPARENT LACK OF DIRECTION AND LEADERSHIP ON THE CONOMIC FRONT. FOR SOME TIME, THE PRESS HAS BEEN CRITICIZING THE GOVERNMENT'S ECONOMIC POLICIES OR LACK THEREOF, BUT THIS IS THE FIRST TIME THAT SUCH CRITICISMS HAVE BEEN AIDED BY A MAJOR PUBLIC FIGURE. THE BASIC COMPLAINT HAS BEEN AND CONTINUES TO BE THAT GOVERNMENT RHETORIC HAS NOT BEEN MATCHED BY GOVERNMENT ACTIONS ON INFLATION. THE GOVERNMENT'S CREDIBILITY HAS THUS COME UNDER QUESTION, ESPECIALLY WHEN IT TRIES TO PLAY A NUMBERS GAME, AS IT DID LAST MONTH, BY "GIMMICKING" THE RIO COST-OF-LIVING INDEX. (SEE BRASILIA 3085)

7. BOTH PUBLICLY AND PRIVATELY SIMONSEN MAINTAINS THAT THE EFFECTS OF MONETARY AND FISCAL RESTRAINTS IMPOSED DURING THE LAST HALF OF 1976 WILL BEGIN TO MAKE THEIR FULL IMPACT FELT BY AROUND MID-LIMITED OFFICIAL USE

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PAGE 03 BRASIL 03671 02 OF 02 091517Z

YEAR, AND THAT THE CRITICS HAVE NOT TAKEN INTO ACCOUNT THE EXPECTED IMPACT OF THESE POLICIES. HE ALSO SAYS THAT, IF BY MID-YEAR INFLATION DOESN'T IMPROVE, ADDITIONAL MEASURES WOULD BE TAKEN. HE CLAIMS THAT HE HAS CONVINCED PRESIDENT GEISEL THAT INFLATION IS THE NUMBER ONE PROBLEM. SIMONSEN IS WORRIED THAT THE SYSTEM OF MONETARY CORRECTION HAS ITSELF BECOME INFLATIONARY. THIS, HE CLAIMS, IS THE REASON WHY THE CDE HAS PROPOSED TO MAKE THE SYSTEM UNIFORM (THE CHANGE MUST BE APPROVED BY THE CONGRESS). HE APPARENTLY PLANS TO SUGGEST OTHER MODIFICATIONS IN THE SYSTEM. SIMONSEN CONTINUES TO BE OPTIMISTIC (AT LEAST PUBLICLY) THAT INFLATION WILL BE IMPROVING BEGINNING MID-YEAR. IN SUPPORT, HE POINTS OUT THAT INDUSTRIAL PRICES ARE DOING MUCH BETTER THAN FOOD PRICES AND, WITH GOOD FOOD HARVESTS IN SIGHT, HE SEES A GRADUAL DECELERATION IN THE RATE OF INFLATION IN THE NEXT 3-4 MONTHS. CRIMMINS

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